

E-132, 299/SA-88-270 DETERMINING COMPENSATION

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Darrel L. Peterson	Chair
Cynthia A. Kitlinski	Commissioner
Norma McKanna	Commissioner
Robert J. O'Keefe	Commissioner
Patrice Vick	Commissioner

In the Matter of the Complaint Regarding the Annexation of a Portion of the Service Territory of People's Cooperative Power Association by the City of Rochester (North Park Additions)

ISSUE DATE: July 11, 1990

DOCKET NO. E-132, 299/SA-88-270

ORDER DETERMINING COMPENSATION

PROCEDURAL HISTORY

I. INITIAL PROCEEDINGS BEFORE THE COMMISSION

On April 22, 1988 People's Cooperative Power Association (People's or the co-op) filed a complaint alleging that the City of Rochester had extended electric service within People's' assigned service area in violation of Minnesota's assigned service area statutes, Minn. Stat. §§ 216B.37 et seq. (1988). The City had extended service to North Park I and North Park II, two residential subdivisions it had recently annexed.

The co-op asked the Commission to prohibit the City from serving the subdivisions. In the alternative, the co-op asked the Commission to determine the amount of compensation due the co-op for the City's acquisition of this portion of its service territory. Finally, the co-op asked the Commission to refer the City's actions to the Office of the Attorney General for penalty proceedings under Minn. Stat. § 216B.61 (1988).

Under Minn. Stat. § 216B.44 (1988), a municipal utility may expand its assigned service area to include any area within its corporate boundaries. If such areas are receiving service from another utility, however, the municipality must first pay the displaced utility appropriate compensation. If the two utilities are unable to agree on compensation, either of them may ask the Commission to determine appropriate compensation. The displaced utility is to continue to serve the area while compensation is being determined, unless the Commission finds, after notice and hearing, that this would not be in the public interest.

In an Order dated June 27, 1988 the Commission found that, given the City's commitment to serve the subdivisions eventually, it would be in the public interest for the City to serve while compensation was being determined. The Commission therefore granted interim service rights to the City. The Commission also declined to refer the City's conduct to the Attorney General for

penalty proceedings. In a separate Order of the same date, the Commission referred the issue of compensation to the Office of Administrative Hearings for contested case proceedings.

II. CONTESTED CASE PROCEEDINGS

Motion for Summary Judgment

The Office of Administrative Hearings duly convened contested case proceedings. On August 19, 1988 the City filed a motion for summary judgment, arguing it should not be required to pay any compensation because it was acquiring no co-op facilities and because there had been no customers receiving service in the area on the date of annexation. Administrative Law Judge Allan W. Klein denied the motion and certified his decision to the Commission.

On March 17, 1989 the Commission issued its Order affirming the denial of summary judgment. The Commission did not, however, adopt the ALJ's conclusion that only one of the four statutory factors to be considered in determining compensation applied in this case.¹ The Commission found that the record required further development before other factors could be ruled out and allowed the parties to present evidence on any of the four factors.

Intervenors

The City and the co-op were original parties to this proceeding. Subsequently, the Department of Public Service (the Department), the Minnesota Municipal Utilities Association (the MMUA), and the Minnesota Rural Electric Association (MREA) filed intervention petitions and were made parties.

The Department is a state agency charged with enforcing the provisions of the Public Utilities Act and representing the public interest in proceedings before the Commission. Minn. Stat. § 216A.07, subds. 2 and 3 (1988). The MMUA is a non-profit corporation organized under the laws of the State of Minnesota representing 129 municipal electric utilities throughout the state. The MREA is an electric cooperative organized under the laws of the State of Minnesota representing 55 electric cooperatives operating within the state.

Evidentiary Hearings

In September of 1989 responsibility for this case was transferred to Administrative Law Judge Phyllis A. Reha.

¹ The four factors to be considered in determining compensation under the statute are as follows: 1. the original cost of the property, less depreciation; 2. loss of revenue to the utility formerly serving the area; 3. expenses resulting from integration of facilities; and 4. other appropriate factors. The ALJ concluded that only the fourth factor applied in this case.

Judge Reha conducted evidentiary hearings at People's' headquarters in Rochester on October 30 and 31, 1989; at Rochester Public Utilities' headquarters in Rochester on November 1, 2, and 3, 1989; and in the Commission's Large Hearing Room in St. Paul on November 6, 7, 8, 9, and 15, 1989.

The Administrative Law Judge also provided opportunity for public comment on October 30 and November 1. One member of the public, Al Schumann from Eyota, Minnesota, spoke.

Two members of the Commission's staff, W. Stuart Mitchell and Betsy Engelking, Rate Analysts, attended all hearings. Commissioner Norma McKanna was also present throughout most of the proceedings.

All parties were represented by counsel. Kenneth R. Moen, Dunlap, Finseth, Berndt and Sandberg, 5th Floor, Marquette Bank Building, Rochester, Minnesota 55903, represented People's. Frederick S. Suhler, Jr., Rochester City Attorney, Room 1, City Hall, Rochester, Minnesota 55902-3164, represented the City of Rochester. Joan Peterson and Eric F. Swanson, Special Assistant Attorneys General, 1100 Bremer Tower, 7th Place and Minnesota, St. Paul, Minnesota 55101, represented the Department. Harold Levander, Jr., Maun and Simon, 2300 World Trade Center, 30 East 7th Street, St. Paul, Minnesota 55101-4904, represented the MREA. Andrew J. Shea, McGrann, Shea, Franzen, Carnival, Straugn and Lamb, Chartered, 1700 Lincoln Centre, 333 South 7th Street, Minneapolis, Minnesota 55402-2436, represented the MMUA.

The record was closed on February 28, 1990, after receipt of initial briefs and reply briefs.

III. SUBSEQUENT PROCEEDINGS BEFORE THE COMMISSION

The Administrative Law Judge filed her FINDINGS OF FACT, CONCLUSIONS, AND RECOMMENDED ORDER on April 2, 1990. Parties filed exceptions to the report and replies to exceptions. On

May 24, 1990 the Commission heard oral argument from all parties. Upon review of the entire record of this proceeding the Commission makes the following Findings, Conclusions, and Order.

FINDINGS AND CONCLUSIONS

IV. JURISDICTION

The Commission has jurisdiction over this proceeding under Minn. Stat. § 216B.44 (1988).

The matter was properly referred to the Office of Administrative Hearings under Minn. Stat. §§ 14.57-14.62 (1988) and Minn. Rules, parts 1400.0200 et seq.

V. FURTHER ADMINISTRATIVE REVIEW

Under Minn. Rules, part 7830.4100 any petition for rehearing, reconsideration, or other post-decision relief must be filed within 20 days of the date of this Order. Such petitions must be filed with the Executive Secretary of the Commission, must specifically set forth the grounds relied upon and errors claimed, and must be served on all parties. The filing should include an original, 13 copies, and proof of service on all parties.

Adverse parties have ten days from the date of service of the petition to file answers. Answers must be filed with the Executive Secretary of the Commission and must include an original, 13 copies, and proof of service on all parties. Replies are not permitted.

The Commission, in its discretion, may grant oral argument on the petition or decide the matter without oral argument.

Under Minn. Stat. § 216B.27, subd. 3 (1988), no Order of the Commission shall become effective while a petition for rehearing is pending or until either of the following: ten days after the petition for rehearing is denied or ten days after the Commission has announced its final determination on rehearing, unless the Commission otherwise orders.

Any petition for rehearing not granted within 20 days of filing is deemed denied. Minn. Stat. § 216B.27, subd. 4 (1988).

VI. STATUTORY BACKGROUND

In 1974 the Minnesota Legislature determined that the orderly development of economical statewide electric service required granting electric utilities exclusive service rights in designated service territories:

It is hereby declared to be in the public interest that, in order to encourage the development of coordinated statewide electric service at retail, to eliminate or avoid unnecessary duplication of electric utility facilities, and to promote economical, efficient, and adequate electric service to the public, the state of Minnesota shall be divided into geographic service areas within which a specified electric utility shall provide electric service to customers on an exclusive basis.

Minn. Stat. § 216B.37 (1988).

The Commission was to establish assigned service areas for all electric utilities by April 12, 1975 and to prepare official service area maps showing the boundaries of the service areas established.

The Legislature recognized that service areas would require adjustment over time. It was considered appropriate, for example, for municipal utilities to expand their service areas as their corporate boundaries expanded. The Legislature therefore established a procedure to allow municipal utilities to acquire parts of other utilities' service areas which lay within their city limits. Minn. Stat. § 216B.44 (1988).

Under that statute, municipal utilities may acquire and serve such areas upon annexation if they are not receiving service from another utility. If annexed areas are receiving service, the municipality must first pay the assigned utility appropriate compensation. If the two utilities are unable to agree on appropriate compensation, either of them may ask the Commission to determine compensation. In the meantime, service by the assigned utility continues, unless the Commission finds, after notice and hearing, that it would not be in the public interest for the displaced utility to serve new customers in the area.

In this case, the utilities were unable to agree on compensation, and the Commission found it would not be in the public interest for the displaced utility to serve new customers while compensation was being determined. The Commission therefore granted interim service rights to the City.

VII. FACTUAL BACKGROUND

The area at issue is a 40-acre tract of land which has been part of People's' assigned service area since service areas were first established. The City annexed the area in March of 1987. On the date of annexation there were no customers in the area. However, a residential developer was about to begin constructing homes in the area and had requested service from People's. On the date of annexation People's had facilities in place capable of providing service to all the homes which would be constructed in the area.

VIII. SUMMARY OF PUBLIC TESTIMONY

Only one member of the public offered testimony at the public hearing. That was Al Schumann, who identified himself as a farmer, builder, former legislator, and member of People's Cooperative Power Association. Mr. Schumann said that People's had invested in the facilities and capacity necessary to serve the North Park Additions and that he and fellow co-op members should not have to support those investments without compensation from the City.

VIII. STATEMENT OF THE ISSUES

The issue in this case is what constitutes appropriate compensation for the statutory rights associated with this

40-acre portion of People's' assigned service area. The City and the MMUA claimed no compensation is due, because the City acquired none of People's' facilities and none of its existing customers. People's and the MREA claim compensation is due,

because People's had invested in facilities capable of serving the area.

People's and the MREA recommended a compensation award of \$148,036. This amount represented the loss of revenues People's would have received from serving the area and an anticipated increase in People's' wholesale power rates due to loss of the North Park loads.

The Department recommended a compensation award of \$25,718. This amount represented the diminution in value of People's facilities due to loss of the North Park loads, lost operating margins (as opposed to lost revenues), and anticipated increases in wholesale power rates.

The Administrative Law Judge recommended a compensation award of \$136,392. This amount represented lost revenues due to loss of the North Park loads.

IX. PEOPLE'S' ELIGIBILITY FOR COMPENSATION UNDER THE STATUTE

For the reasons set forth below, the Commission finds that People's is entitled to compensation for the City's acquisition of the North Park Additions.

The Area was Receiving Service from People's

If the area at issue was receiving service from People's when the City decided to acquire it, appropriate compensation is required under Minn. Stat. § 216B.44 (1988). The City and the MMUA claim that the absence of actual customers in the area requires a finding that it was not receiving service within the meaning of the statute. The Commission has long rejected this interpretation as inconsistent with the purposes of the Public Utilities Act and inimical to sound utility regulation. The Commission continues to do so.

As the Commission has noted before, the generation, transmission, and distribution of electricity is an extremely capital-intensive business. Utilities must be willing and able to commit large amounts of capital to building and maintaining the facilities necessary to deliver power throughout their service territories, including areas where there are currently no customers.² Since power plants require years of planning and construction, utilities must also be willing to commit these resources years in advance of actual need. They do this in reliance on carefully drawn long range plans. For this reason the "actual customer" test proposed by the City and the MMUA is unworkable.

It would be unfair to foreclose utilities from serving areas they have made investments to serve, without awarding compensation, just because the customers on whose behalf the investments were made are not yet present. The inequity is especially obvious in this case, where the developer building homes in the area had requested service from People's before the City decided to serve it. Such a policy would also undermine utilities' confidence in service area stability, decreasing their

² See Minn. Stat. § 216B.04 (1988), requiring public utilities to provide service to new customers within 90 days of application for service.

willingness to invest to meet the future needs of their service areas and jeopardizing the statutory goal of ensuring economical, efficient, and adequate electric service throughout the state. Minn. Stat. § 216B.37 (1988).

For these reasons, the Commission has consistently interpreted the statutory phrase "receiving electric service" to include those situations in which the assigned utility has in place facilities capable of serving the area. The Court of Appeals has recently upheld this interpretation in the Matter of the Complaint by Kandiyohi Cooperative Electric Power Association against Willmar Municipal Utilities Commission for Extending Electric Facilities in and Adjacent to Westwind Estates, 455 N.W.2d 102 (Minn. Ct. App. 1990).

Since there is no dispute that People's had facilities in place capable of providing service to the North Park Additions on the date of annexation, the Commission finds that the area at issue was receiving service from People's.³ Appropriate compensation for the City's acquisition of the area is therefore required.

The Fact that the City Will Not Take Possession of Any Co-op Facilities Does Not Defeat the Co-op's Compensation Claim

The City and the MMUA argued that the statutory emphasis on acquisition of facilities means no compensation is due when a municipality does not take possession of facilities owned by the displaced utility. The Commission disagrees.

The statutory language regarding the determination of compensation is as follows:

Notwithstanding the provisions of sections 216B.38 to 216B.42, whenever a municipality which owns and operates an electric utility (a) extends its corporate boundaries through annexation or consolidation, or (b) determines to extend its service territory within its existing corporate boundaries, the municipality shall thereafter furnish electric service to these areas unless the area is already receiving electric service from an electric utility, in which event, the municipality may purchase the facilities of the electric utility serving the area. The municipality acquiring the facilities shall pay to the electric utility formerly serving the area the appropriate value of its properties within the area which payment may be by exchange of other electric utility property outside the municipality on an appropriate basis giving due consideration to revenue from and value of the respective properties. In the event the municipality and the electric utility involved are unable to agree as to the terms of the payment or exchange, the municipality or the electric utility may file an application with the commission requesting that the commission

³ These facilities included four substations, transmission and distribution lines, and a three-phase line running along the south boundary of the North Park additions. The co-op had also acquired power supplies sufficient to serve the developments from its wholesale supplier, Dairyland Power Cooperative.

determine the appropriate terms for the exchange or sale. After notice and hearing, the commission shall determine appropriate terms for an exchange, or in the event no appropriate properties can be exchanged, the commission shall fix and determine the appropriate value of the property within the annexed area, and the transfer shall be made as directed by the commission. In making that determination the commission shall consider the original cost of the property, less depreciation, loss of revenue to the utility formerly serving the area, expenses resulting from integration of facilities, and other appropriate factors. . . .

Minn. Stat. § 216B.44 (1988).

The Commission is obligated to interpret this statute reasonably and in accordance with its intended purpose. It would be incongruous and unreasonable to interpret the statute to prohibit compensation when a municipality does not take possession of a displaced utility's facilities, even though the displaced utility actually incurs loss of revenue or other statutory damages.

First of all, the language of the statute does not support this interpretation. The compensation formula does not limit compensation to the value of facilities which actually change hands. Instead, it contains four factors -- original cost of facilities less depreciation, loss of revenue, system integration costs, and other appropriate factors. This formula, particularly the inclusion of lost revenues, evidences a legislative intent to place the displaced utility in the same financial position it would have occupied had the acquisition not occurred.

Furthermore, the City's and the MMUA's interpretation would lead to absurd results. It would allow municipalities to carve out for themselves large portions of other utilities' service areas, carefully bypassing sites on which facilities were located, and thereby avoid paying compensation. Obviously, this would be both inequitable and at odds with the statutory goals of promoting the orderly development of adequate statewide electric service and avoiding unnecessary duplication of facilities. Minn. Stat. § 216B.37 (1988).

Similarly, it could force the Commission to choose between denying compensation to displaced utilities or requiring municipalities to buy facilities which could more economically be retained by displaced utilities. The first of these two choices would cause manifest injustice and contravene the established public policy of encouraging utilities to plan and invest to meet the future needs of their service areas. The second would contravene the statutory goals of avoiding unnecessary duplication of facilities and promoting economical service. Minn. Stat. § 216B.37 (1988).

Furthermore, the Commission finds that the City's and the MMUA's construction of the term "acquisition" is much too narrow. It is a basic principle of property and eminent domain law that a taking can occur without a transfer of physical possession; it can also occur if the value of the property is substantially reduced, or the owner's reasonable use and enjoyment of the property substantially diminished. The Commission finds the analogy from property and eminent domain law

helpful but not dispositive.⁴ Here, the City's action deprived the co-op of one of the major attributes of its property, the revenue stream it was reasonably expected to generate. The Commission finds that this constitutes an acquisition within the meaning of the statute.

The Commission therefore rejects the City's and MMUA's interpretation of the compensation statute as unreasonable and inconsistent with the purposes of the statute.

At the same time, the Commission agrees with the City and the MMUA that the statute's emphasis on facilities is meaningful. That emphasis makes it clear that the statute does not intend to provide a windfall to displaced utilities which have made no investments to serve annexed areas. Only displaced utilities which have made good faith investments to serve annexed areas, and have facilities in place to do so, qualify for compensation under the statute.⁵ This is consistent with the Commission's interpretation of the statutory phrase "receiving electric service," with its overall construction of the Public Utilities Act, and with the policies underlying the service area legislation, discussed above.

The City's Right to Acquire the Area Does Not Make the Co-op's Right to Serve it Non-compensable

The City and the MMUA also argued that no compensation is due People's because the property right represented by People's' right to serve the annexed area is illusory. It is illusory because it can be extinguished at any time by the City's exercise of its right to acquire the service area. Similarly, they argued that People's right to serve the area is not compensable because the City's ability to acquire it at any time reduced its economic value to zero.

The Commission disagrees. The Legislature determined that a displaced utility has a compensable right to serve by mandating compensation and setting criteria for compensation in Minn. Stat. 216B.44 (1988). The statute requires this because displaced utilities have an obligation to make the investments necessary to ensure their ability to serve areas municipalities may later decide to serve.

⁴ In non-public utility eminent domain proceedings, a taking can occur without physical possession, but loss of revenue is not compensable in and of itself. It can only be considered as evidence of a decrease in fair market value, because many complex and intangible variables, such as the proprietors' initiative and industry, affect revenues. Hendrickson v. State, 267 Minn. 436, at 447; 127 N.W.2d 165 (1964). In public utility eminent domain proceedings, the Legislature, recognizing the uniqueness of the utility industry, specifically required that damages include lost revenues. Minn. Stat. § 216B.47 (1988).

⁵ The Commission agrees with the ALJ that reasonable construction of the statute would disallow compensation for facilities installed for purposes of inflating a compensation award. The Commission also agrees with the ALJ that the facilities in place to serve the area at issue were installed in good faith and pursuant to prudent planning. In the 1960's, People's forecast significant growth in its service territory and installed the facilities at issue to accommodate that growth.

This obligation is not illusory, and neither is the right to compensation which flows from it.

Furthermore, the City and the MMUA attach undue significance to the City's statutory right to acquire portions of People's service territory by eminent domain or Commission Order. All property rights are subject to the proper exercise of the eminent domain powers of state and local governments, as well as the proper exercise of their less intrusive police powers. The municipal acquisition provisions of the assigned service area statutes do not grant municipalities rights drastically different in nature and kind from those available under their powers of eminent domain. The Commission refuses to infer from the service area statutes any legislative intent to degrade the co-op's right to serve the annexed area to illusory status. To the contrary, the Commission finds that those statutes demonstrate clear legislative intent to ensure appropriate compensation when municipalities expand their assigned service areas at the expense of other utilities.

People's Lack of a Franchise is not a Barrier to Compensation

The City and the MMUA also argued that People's lack of a franchise to serve the North Park Additions bars its claim to compensation. The Commission has rejected this argument on previous occasions and continues to do so.

The service area statutes make it clear that municipal franchise requirements cannot alter service area boundaries set by the Commission. Franchise requirements can relate only to matters such as public safety, rights of way, and revenue collection. Authority over rate and service regulation, service area assignments, and securities and indebtedness is vested exclusively in the Commission. Minn. Stat. § 216B.36 (1988), emphasis added. People's lack of a franchise does not relieve the City of its obligation to compensate the cooperative for the acquisition of its property.

X. THE APPLICATION OF THE COMPENSATION FORMULA

The assigned service area statute requires the Commission to consider the following factors in determining compensation:

1. the original cost of acquired property, less depreciation;
2. loss of revenue to the utility formerly serving the area;
3. expenses resulting from integration of facilities; and
4. other appropriate factors. Each factor will be considered in turn.

The Original Cost of Acquired Property

All parties agree that it would be neither reasonable nor in the public interest for the City to buy any of People's facilities in the course of this service area acquisition. The Commission agrees with the parties. The amount of compensation due under the first factor is therefore zero.

Loss of Revenue

The Administrative Law Judge (ALJ) determined that the City's acquisition of the area at issue resulted in a \$136,393 loss of revenue to People's. The Commission agrees.

The ALJ reached this conclusion by calculating the revenues People's would have received from serving the area, subtracting expenses it would have incurred to do so, projecting the loss over ten years, adjusting for inflation, and reducing the resulting figure to present value. This analysis has been employed by the Commission in the past and is a straightforward method of determining compensation. Its goal is to put the displaced utility in the same position it would have occupied had the acquisition not occurred.

Determining Lost Sales -- The ALJ calculated the revenues People's would have received from serving the area by determining average usage per developed lot and multiplying that figure by the total number of lots. Since the area was 94% developed as of July 1, 1989, it was reasonable to assume full development would occur. This is clearly a reasonable and accurate method for determining lost sales.

Deducting Expenses -- The ALJ deducted from lost sales revenues all identifiable expenses which would have been directly attributable to serving the North Park Additions. These deductions included costs such as the cost of installing primary and secondary distribution systems, billing and collection costs, higher depreciation expense, and higher interest expense. She then used an expense residual analysis to determine what portion of fixed and common costs revenues from serving the area would have contributed. This amount, too, was deducted from recoverable lost revenues.

Expense residual analysis is based on cost of service principles similar to those the Commission uses in examining rate design issues. It determines the cost of serving specified customers (in this case, customers residing in the North Park Additions) in terms of their number and relative contribution to peak demand. It then allocates fixed and common costs on that basis. The Commission finds that the ALJ used a sound and reasonable method to determine the expenses People's would have incurred, had it been allowed to serve the North Park Additions.

Ten Year Time Frame -- The Commission also agrees with the ALJ's use of a ten year time period for calculating loss of revenues in this case. As the ALJ pointed out, the loss of revenues sustained by the co-op is in theory perpetual. As a practical matter, however, an actual time period must be used, and ten years is the most reasonable one supported in the record. The co-op supported cutting off recovery after ten years, stating long range planning is normally conducted for ten year periods. The Commission has also used a ten year period in the past,⁶ finding that ten years is a standard planning horizon for rural electric co-operatives for the construction of basic utility facilities such as substations and major feeders.

⁶ See, In the Matter of the Application of the City of Olivia to Extend Its Municipal Electric Service Area into an Area Served by Renville-Sibley Cooperative Power Association, Docket No. E-288, 136/SA-85-93, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER SETTING COMPENSATION FOR SERVICE EXTENSION (June 27, 1986).

The City and the MMUA opposed the ten year time frame, on grounds that actual construction occurs in accordance with construction plans prepared at two or three year intervals. Construction plans implement the requirements of long range plans, however. They are not the result of comprehensive re-examination of the service needs of a utility's assigned service area. Furthermore, once facilities are installed pursuant to long range plans, they remain in place, whether or not anticipated loads materialize. The Commission concludes that ten years is a more reasonable time frame for measuring People's' revenue losses than the two or three years represented by construction plans.

Inflation Rate -- In determining revenues and expenses for future years, the ALJ used an inflation rate of 4.1%. This figure was based upon "consensus" projections for inflation from 1991-95 and 1996-2000, published in Blue Chip Economic Indicators, March, 1989. The Commission finds this is a reasonable estimate of future inflation and will adopt it.

Discount to Present Value -- To reduce future lost revenues to present value, the ALJ used the co-op's blended borrowing rate of 6.5%. The ALJ found, and the Commission agrees, that its blended borrowing rate represents the co-op's most realistic alternative investment opportunity. The Commission therefore approves and adopts the ALJ's method of discounting lost revenues to present value.

The City's Assumption of Risk -- The City and the MMUA argued that allowing recovery of lost revenues was inappropriate in this case because the City had assumed risks associated with the development of the area at issue. The Commission disagrees. In this case private developers purchased and developed the North Park Additions land. Development contracts with the City required the developers to pay for the cost of roads, sewer service, and water service to the Additions. The costs of trunk sewer and water facilities are assessed to benefitted properties. None of these assessments have been written off by the City, and the ALJ determined that the probability of the City not recovering assessments against the North Park Additions was zero. Maintenance costs of sewer and water facilities are recovered through user fees. Road maintenance costs are paid through the general fund, which is financed by property taxes.

In an earlier case cited by the City, In the Matter of the Application of the City of Olivia to Extend Its Municipal Electric Service Area into an Area Served by Renville-Sibley Cooperative Power Association, Docket No. E-288, 136/SA-85-93, the Commission did decline to award a co-op lost revenues because of the risk the City had assumed in developing the annexed area at issue. In that case, however, the City had spent \$500,000 in City funds to purchase industrial park property and to install road, sewer, and water utilities for the industrial park. Without the City's investment, it was extremely unlikely that the growth which did occur in the area would have occurred. Clearly, the conditions which led the Commission to deny recovery of lost revenues in Olivia are not present in this case.

New Material in Exceptions -- During the evidentiary hearings, there was no serious dispute about the appropriate inflation rate or the appropriate discount rate for reducing lost revenues to present value. Similarly, the City and the MMUA declined to sponsor testimony supporting an alternative

compensation award greater than zero or proposing alternative methods of computing lost revenues. Both parties, however, filed Exceptions to the ALJ's report proposing new methodologies for determining various components of the compensation award.

The Commission agrees with the Department that the appropriate time to introduce these methodologies was during the evidentiary hearings. It is now too late for the Commission to receive this evidence, since it would not be subject to cross examination or discovery. Other parties would have no opportunity for careful analysis of these methodologies and their theoretical and factual underpinnings; the Commission would not have the benefit of their thorough analyses. For these reasons, the Commission declines to consider those portions of the City's and the MMUA's Exceptions which introduce factual and analytical material which should have been provided during the evidentiary hearings: the City's Exception No. 13 and all portions of the MMUA's Exceptions other than the specific Exceptions set forth on pages 6 through 12.

The Department's Approach -- The Department argued that People's should receive no compensation for lost revenue because the co-op had not lost actual customers or sustained an actual decrease in revenues when the City decided to serve the area. The Department instead recommended compensation based on the diminution in value of the co-op's facilities caused by the City's decision to serve, its lost operating margins, and wholesale rate increases likely to result from the loss of the North Park loads.

The Commission disagrees, because the Department's methodology fails to place the co-op in the same position it would have occupied but for the City's acquisition of its service area. If the City had not acquired its service territory, People's would be receiving the revenues the City is now receiving from serving the North Park Additions. Those revenues are actual and calculable. They are what the co-op has lost by virtue of the City's acquisition of its service territory.

The statute does not make a distinction between revenues the displaced utility was receiving and lost, and revenues the displaced utility clearly would have received and lost. The statute merely requires the Commission to include "loss of revenue" in its compensation award.

The Commission believes a displaced utility's right to compensation for lost revenues should not depend on whether it actually served a particular customer, but on whether it would have served the customer but for the municipality's acquisition

of its service territory. Limiting recovery of lost revenues to situations in which actual customers changed hands would result in compensation awards varying drastically, depending upon whether a particular municipality had the foresight and technical expertise to time its annexation or declaration of intent to serve to precede the presence of a customer actually receiving service. It could result in displaced utilities receiving no compensation for lost revenues after making substantial investments to serve annexed areas which cities decided to serve at the eleventh hour. Such an interpretation would be at odds with the statutory goals of avoiding unnecessary duplication of facilities, encouraging investment to meet future needs, and avoiding disputes between utilities. Minn. Stat. § 216B.01 (1988).

The Department's approach may have merit in other contexts, where lost revenues are speculative, cannot be measured, or other factors make their recovery impractical or inequitable. Here, however, the Commission finds that lost revenues are clear, measurable, and should be awarded under the statute.

Expenses Resulting from Integration of Facilities

Since the City will not be acquiring any of the co-op's facilities, the co-op will not incur any expenses for integration of remaining facilities. The amount of compensation due under the third statutory factor is therefore zero.

Other Appropriate Factors

People's sought compensation of \$11,644 for an anticipated incremental increase in the wholesale power rates charged by its supplier, Dairyland Power Cooperative, due to loss of the North Park loads. The Department and the MREA supported this request; the City and the MMUA opposed it.

The ALJ found the anticipated wholesale rate increase too speculative to warrant compensation. The Commission disagrees.

It is true that wholesale power rates are subject to many complex and interrelated factors, and that the effects of a change in any single factor may be overwhelmed by changes in others. At the same time, however, it is clear that the more units of power a supplier sells from fixed facilities, the lower the portion of fixed and common costs each unit must contribute. The evidence in the record clearly shows that People's' wholesale supplier has abundant capacity and would not have had to incur new plant expense or other increases in fixed costs to serve the North Park loads. Instead, the North Park loads would have provided an opportunity to spread existing fixed costs over a broader customer base.

Clearly, then, People's will pay more per unit of wholesale power than it would have paid had it served the North Park loads. The fact that many other factors will affect People's wholesale power rates does not change the fact that, whatever its ultimate rates, they will be higher without the North Park loads than with them. Under these circumstances, compensation for increased wholesale power costs is warranted.

The Commission is satisfied that People's' calculations of increased wholesale power costs are reasonably accurate and should be adopted. People's used the expense residual analysis discussed

earlier. This is a standard analytical method relied upon by this and other commissions in the rate design phase of the ratemaking process. It is equally appropriate in this context. People's' figures are based upon actual usage in the North Park subdivisions and upon an historical test year. This, too, is consistent with standard regulatory practice. Amounts claimed were adjusted for inflation and reduced to present value, using the ten year time frame approved earlier. The Commission will therefore include in the compensation award the \$11,644 in increased wholesale power costs sought by People's.

XI. TOTAL COMPENSATION AWARD

The Commission finds that People's was serving the area at issue when the City annexed and decided to serve the area, entitling People's to compensation under Minn. Stat. § 216B.44 (1988). Proper application of the compensation formula results in compensation of \$136,393 for lost revenue and compensation of \$11,644 for increased wholesale power costs, for a total compensation award of \$148,037.

ORDER

1. The Commission finds that appropriate compensation to People's Cooperative Power Association for the City of Rochester's acquisition of the portion of its service territory at issue is \$148,037.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)

ATTACHMENT A

BEFORE THE MINNESOTA OFFICE OF ADMINISTRATIVE HEARINGS

400 Summit Bank Building
310 South Fourth Avenue
Minneapolis, Minnesota 55415

FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION

780 American Center Building
160 East Kellogg Boulevard
St. Paul, Minnesota 55101

In the Matter of the Application of the City of
Marshall to Adjust and Update the Assigned
Service Area Maps to Incorporate an Annexed
Area Presently Served by Marshall and to
Clarify Interim Service Rights in Said Area

MPUC Docket No. E-272,125/SA-
90-484

OAH Docket No.

NOTICE OF APPEARANCE

Date of Hearing: To be determined by Administrative Law Judge

Name and Telephone Number of Administrative Law Judge:

Richard C. Luis
612/349-2542

TO THE ADMINISTRATIVE LAW JUDGE:

You are advised that the party named below will appear at the above hearing.

NAME OF PARTY:

ADDRESS:

TELEPHONE NUMBER:

PARTY'S ATTORNEY OR OTHER REPRESENTATIVE:

OFFICE ADDRESS:

TELEPHONE NUMBER:

SIGNATURE OF PARTY OR ATTORNEY: _____

DATE: _____